BRIEF IN SUPPORT OF PETITION.

Opinions Below.

The opinion of the Circuit Court of Appeals for the Seventh Circuit is reported at 112 F. (2d) 260. The opinion of the Board of Tax Appeals (R. 73) is not reported.

Statement of the Case.

A statement of the case appears in the petition for the writ at pages 2 to 7, and for the sake of brevity is not repeated here.

Specification of Errors to Be Urged.

The Circuit Court of Appeals erred:

1. In holding that under Section 281 (a) of the Revenue Act of 1926 the executors, upon qualification, became the taxpayer in place of Rew and the transferors of property in fact transferred by Rew.

2. In holding that this proceeding was not barred by Section 280 of the Revenue Act of 1926.

3. In holding that the judgment against the executors in the prior proceeding was *res judicata* of the alleged tax liability in the present proceeding.

4. In failing to hold that the sales restrictions in the contract of December 31, 1923, under which Rew received the securities from Peabody, Houghteling & Co. deprived the securities of an ascertainable fair market value sufficient to support an income tax upon their receipt.

5. In failing to remand the case to the Board with directions to find facts showing whether the sale of securities occurred in 1923 or 1924.

6. In holding that the petitioners became transferees who are liable for the alleged income tax liability of Rew.

ARGUMENT.

I.

The Decedent Rew, and Not the Executors of His Estate, Was the Transferor and the Taxpayer in This Case Under the Federal Revenue Acts and the Law of Illinois, and the Proceeding Against the Executors Did Not Suspend the Running of the Statute of Limitations in Favor of Petitioners or Make the Prior Judgment Res Judicata as to Them.

It is not surprising that when the oral argument was reached in the Court of Appeals counsel for the Commissioner thought it desirable to support his contention by some federal statute and therefore referred for the first time to Section 281 (a) of the 1926 Revenue Act, forgetting evidently that that section was not enacted until after the death of Rew and the qualification of his executors. The opinion of the Board of Tax Appeals was not based upon any federal statute but upon phrases, principally from Illinois cases, to the effect that an executor "stands in the shoes" or "in the place" of the decedent. These phrases were held sufficient to make the decedent and his executor one and the same person.

Strangely enough these phrases were cited from Illinois cases in which the Supreme Court of that state expressly held that an executor had no concern with and no rights in relation to property which was transferred by the decedent in his lifetime. It was just because the decedent was himself the transferor of such property that it was held that the executor could not make it part of the personal property in the estate, with which alone he was concerned. Property transferred by the decedent can

never in Illinois come into the possession or control of the executor. Only creditors of the decedent can set such a transfer aside for their benefit.

Sifford v. *Cutler,* 244 Ill. 234, 236.
Choteau v. *Jones,* 11 Ill. 300, 320.

It follows of course that a judgment against an executor could not relate to property with which he could never be concerned. The Supreme Court of Illinois has therefore held that a judgment against an executor is binding only as to property to which he is entitled, and is of no effect as to property of the decedent which goes directly to his heirs or which has passed to others during his lifetime.

McGarvey v. *Darnall,* 134 Ill. 367, 370, 372.
Smith v. *Hunter,* 241 Ill. 514, 518.

It follows also that it is useless for any creditor of a decedent, including the Government, to pursue an executor of a decedent on account of property so transferred when all the time the creditor has the sole right himself to proceed against the transferee. A fruitless proceeding against the executor could not suspend the creditor's independent right, which has existed all the time, to proceed against the transferee on account of property that never passed into the hands of the executor.

The decisions of this Court are to the same effect. The application of the statute of limitations in such a case was clearly stated in an early case, *Ingle* v. *Jones,* 9 Wall. 486, where this Court said (p. 495):

> "* * * The duties of the administrator are confined to the personal estate, and never extend beyond it. If that be insufficient to discharge the debts, and it be necessary to resort to the realty of the deceased for that purpose, a proceeding against the heir must be instituted. In that event, whatever has been done by the administrator is without effect, as to the prop-

> erty sought to be charged. A judgment against the administrator is not evidence against the heir. The demand must be proved in all respects as if there had been no prior proceeding to effect its collection, *and the statute of limitations may be pleaded with the same effect as if there had been no prior recovery against the personal representative.*" (Italics ours.)

This Court has also held that where a voluntary transfer leaves a party insolvent there is no bar which prevents a creditor from proceeding immediately and directly against the holder of the assets so transferred.

Case v. *Beauregard*, 101 U. S. 688, 690.

And in dealing with the provisions of the 1926 Revenue Act this Court has held that there is no suspension of the statute of limitations under the transferee provisions where the Commissioner is not in fact prohibited from assessing the transferee liability.

United States v. *Continental National Bank & Trust Company*, 305 U. S. 398.

Similar principles apply in the application of the plea of *res judicata*. The universal holding of the courts in this country is that in order to bind a person who has not been a party to litigation that person must be in privity with a person actually involved in the litigation.

Bigelow v. *Old Dominion Copper Co.*, 225 U. S. 111, 126-129.

United States v. *California Bridge Co.*, 245 U. S. 337, 341.

This Court has defined privity in the *Bigelow case* as follows (p. 128-129):

> "What is privity? As used when dealing with the estoppel of a judgment, privity denotes mutual or successive relationship in the same right or property."

Therefore the courts have held that there is no privity between an administrator or executor and an heir.

Ingle v. *Jones,* 9 Wall. 486, 495.
McGarvey v. *Darnall,* 134 Ill. 367, 370.
Smith v. *Hunter,* 241 Ill. 514, 518.
Kamerer v. *Kamerer,* 281 Ill. 587.

These cases are all inconsistent with the decision of the Court of Appeals in this case. If the executor is the same person as the decedent then an heir is in privity with the executor just as much as is a transferee of the decedent in his lifetime. An heir also would be a transferee of the executor as well as of the decedent.

In order to avoid the effect of these decisions the Court of Appeals ignored them altogether. Instead it referred to the case of *Sanborn* v. *Helvering,* 108 F. (2d) 311, a case involving the relation of an executrix to a legatee, as if it presented the same situation on the question of privity that exists in this case. No question regarding a tax due by a decedent was involved in that case. The tax in question related to the year after the decedent's death. The taxpayer was the estate. There may have been a question as to whether, in view of the time of the discharge of the executrix, the tax was incurred by the estate or by the legatee, but the court held that the legatee, also the executrix, was in no position to claim that the estate was not the taxpayer. There was no question in the case which has any bearing on the issues in the pending case. Of course, in the *Sanborn* case the statute of limitations was suspended by the pendency of proceedings against the taxpayer, the estate, with reference to the same property which passed from the taxpayer to the legatee. The property involved in the pending case never passed to the executors at any time.

When the oral argument in the Court of Appeals was

reached counsel for the Commissioner had reason for being in doubt about his position. Therefore for the first time he called attention to Section 281 (a). This section is by its terms applicable to all persons occupying a fiduciary position. It does not attempt to change the law of the country with reference to the position of executors and administrators. In order that it should become effective in any case Subsection (c) of Section 281 required that a notice should be given by the fiduciary "in accordance with regulations prescribed by the Commissioner with the approval of the secretary."

The regulations (Reg. 69 Art. 1292) issued under Section 281, provide as follows:

> "The 'notice to the Commissioner' provided for in section 281 shall be a written notice signed by the fiduciary and filed with the Commissioner. The notice must state the name and address of the person for whom the fiduciary is acting, and the nature of the liability of such person; that is, whether it is a liability for taxes, and, if so, the year or years involved, or a liability at law or in equity * * *."

The regulations further provide,

> "Unless there is already on file with the Commissioner satisfactory evidence of the authority of the fiduciary to act for such person in a fiduciary capacity, such evidence must be filed with and made a part of the notice."

From the foregoing it is clear that the Court of Appeals, in relying on Section 281 in this case, when no notice under Section 281 was given, disregarded the specific terms of the statute. In order to bring the statute into operation the notice provided for must be in the form prescribed by the regulations. It is also apparent from the last portion of the regulations quoted above that information coming to the Commissioner in any other way does not satisfy that statute.

Moreover, Section 281(a) refers by its terms to the prop-

erty with reference to which the person giving the notice is acting as a fiduciary and provides that any tax shall be collected from the estate of the taxpayer. It does not attempt to confer, and could not confer, any jurisdiction over property with reference to which the person giving the notice is not acting as a fiduciary. A fiduciary can act as a fiduciary only with reference to the property in regard to which he is a fiduciary. Section 281(a) cannot make the fiduciary the owner or transferor of property which he does not hold as a fiduciary and confers power solely as to taxes which are to be paid out of the taxpayer's estate. Any judgment against such fiduciary can relate only to the property with which the fiduciary as such fiduciary is concerned. Section 281(a) therefore is entirely consistent with the settled law of the whole country on the scope of the powers of an executor or other fiduciary.

We have already called attention to the fact that Section 281 (a) was not enacted until after Rew had died. For this reason also this statutory provision has no proper place in this case. The Second Circuit Court of Appeals so held in *Liberman's Committee* v. *Commissioner,* 54 F. (2d) 527. In that case the Government contended that Section 281 (a) applied where fiduciaries had filed a return prior to the enactment of Section 281 and where, as in the instant case, no notice had ever been given to the Commissioner under Section 281. In denying the contention that 281 applied, the Court stated (page 529):

> "Secondly, and this seems to us a conclusive answer to the contention, section 281 (a), 26 U. S. C. A. Section 1070 (a), speaks prospectively from the date of its enactment, February 26, 1926, * * * *and relates only to actual fiduciaries who thereafter give notice to the Commissioner that they are acting as such.*" (Italics supplied.)

The Court in that case also disposed of the contention that the filing of the return by the fiduciary prior to the

enactment of the statute could operate as a substitute for the notice required by the statute.

Nevertheless, without referring to any statutory provision which can have any application, except this Section 281 (a), the Court of Appeals in this case says (R. 98):

> "In considering this question, we cannot rely entirely upon the ordinary rules governing privity of parties or of estates. On the contrary, we must keep in mind the theory of income taxation as reflected by the controlling legislation. Congress has seen fit, in order to prevent evasion of taxes, to fix a tax liability not only upon the transferor of property but, in case of his inability or failure to pay, likewise upon assets transferred by him.
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> "* * * There is in this situation privity of title to the assets transferred and now sought to be reached by virtue of the statute. The presence of the executors need not confuse us. They are, for the purpose of determination, the transferor himself,—they are merely the voice of one who can no longer speak for himself and speak only for him and in his behalf. * * * We are not persuaded that the transferee may relitigate the tax liability fixed against his transferor; the transferee is bound by all that was decided and all that might have been decided in the prior litigation."

This language is used, as we have already pointed out, in the face of the statement of this Court in *Hartley* v. *Commissioner*, 295 U. S. 216, 218, that:

> "The revenue acts consistently treat the estate of a decedent in the hands of an administrator or executor as a separate taxpayer."

Also in *Hulburd* v. *Commissioner*, 296 U. S. 300, this Court considered the position of executors in Illinois under the law of Illinois and reversed this same Circuit Court of Appeals in a tax case because of its disregard of the law of that state. In this case the law of Illinois is completely ignored on the ground that the revenue acts have overruled that law, and the statement of this Court to the contrary is also ignored.

So far as the statute of limitations is concerned the holding of the Court is in direct conflict with the express language of Subsection 280 (c). That section, instead of providing that, in the case of the death of a taxpayer, his executor shall take his place and become the taxpayer, defines the decedent as still the taxpayer and provides that the period of the statute of limitations shall be the same that it would be had the taxpayer not died. This can mean only that as to other parties liable for taxes due by the decedent the statutory period is not changed. In this case that period expired in 1929, five years after the tax return for the decedent was made—the four year period fixed by Section 277 (a)(2) of the 1926 Act, plus one year granted by Section 280 in the case of a transferee.

The only support for the Court of Appeals decision to which it refers is Section 281 (a) of the Revenue Act of 1926. It states that:

> "Under Section 281 (a) the executors, upon qualification, so far as the liability of Rew for income tax was concerned, assumed the power, rights, duties and privileges of the taxpayer." (R. 96.)

And this is later stated to mean that, for the purpose of the determination of this case, the executors are "the transferor himself." (R. 98.)

There is nothing in the language of this section which suggests that executors can be treated as if they did the things which the decedent himself did. It does not purport to establish a new and special law as to executors or administrators in income tax cases. It applies to all fiduciaries. The Court of Appeals, however, turns it into a statute which changes the settled law in regard to executors or administrators.

The Court of Appeals also says, as quoted above, that:

> "Congress has seen fit, in order to prevent evasion of taxes, to fix a tax liability not only upon the transferor of property but, in case of his inability or failure

> to pay, likewise upon assets transferred by him" (R. 98).

Congress has done nothing of the kind; it has created no such liability. It has relied upon the general law with reference to the liability of transferees and has merely added certain administrative provisions regarding transferees. The entire statement of the Court of Appeals which we have quoted above finds no support whatever in the revenue acts. It is simply an invention of that Court.

In any event it was too late to bring Section 281 (a) into the case for the first time at the oral argument in the Circuit Court of Appeals. This change did not mean merely a new theory to support the decision of the Board and the Commissioner. It made a new case which was not presented before. Instead of a case arising on the basis of principles of the common law or the local law of Illinois, a federal statute was brought in for the purpose of claiming that the local law might be superseded by a federal statute which revolutionized the established law and identified the executor of an estate with the decedent in such a way that, for income tax purposes, the executor could be regarded as doing the things the decedent himself did while alive. This Court has held that such a change in a case cannot be made for the first time in an appellate court.

General Utilities & Operating Co. v. *Helvering*, 296 U. S. 200.

Helvering v. *Tex-Penn Oil Co.*, 300 U. S. 481, 498.

Helvering v. *Wood*, 309 U. S. 344, 349.

II.

There Is No Ground for the Assertion of a Tax Liability Against Petitioners in This Case.

1. On December 31, 1923, Rew entered into an agreement to exchange with Peabody, Houghteling & Co. 6,150 shares of the preferred stock of Calumet Baking Powder Company for certain miscellaneous unlisted securities (Rec. 11-14). Under that contract Rew could not sell or negotiate for the sale of or pledge any of the securities received by him for a period of six months from and after December 31, 1923. The record further shows that there was no market on which Rew could have sold the securities if he had been free to sell and that they had no fair market value which could afford the basis of the tax claimed. Under such circumstances the decision of this and other federal courts is to the effect that no taxable gain is realized.

Helvering v. *Tex-Penn Co.*, 300 U. S. 481, 489.
Schuh Trading Co. v. *Commissioner*, 95 F. (2d) 404.
Propper v. *Commissioner*, 89 F. (2d) 617.

2. It is not disputed that the shares of stock in question in this case were delivered by Rew to the purchaser on December 31, 1923, in pursuance of a contract made and executed on that date. The bonds received by Rew within a few days were delivered and received in satisfaction of the provisions of the contract and the gain was realized if at all on December 31, 1923. In the prior case involving the executors no attack was made on the findings of fact by the Board and no record of the evidence was presented to the Court of Appeals. In this case the record presents the evidence and the Board was requested to reexamine the testimony and make a finding of fact in accordance with the evidence. This request was ignored. We submit that

this refusal of the Board to make such a finding is error which should require a reversal of this case.

3. The record in this case shows no ground upon which the petitioners can be held liable as transferees. The Board found that after Rew made an irrevocable trust dated December 31, 1923, "he was still solvent and retained sufficient assets to pay his tax liability here in question" (Rec. 79). Rew made a revocable trust on March 10, 1924, and it is this revocable trust which is held liable for the tax in question.

The Board states that this revocable trust "left the decedent and his estate insolvent" (Rec. 80). The Board, however, does not state on what ground the liability of petitioners is based and the Court of Appeals ignores the question. Under the trust of March 10, 1924, Rew retained the income for life and an unlimited power of revocation. He was just as solvent after March 10th as he was before, and for tax purposes he was still regarded as the owner of the trust property. Clearly the claim against petitioners must be based upon the unexpected death of Rew in June and not upon the transfer in March. Insolvency at death has no relation to insolvency when such a trust was created, no matter how long before death that may have been. Tax liability is a practical matter and it is held that the liability of a grantor is not changed by the creation of a revocable trust or a short term trust. The trust may be disregarded, but death is another matter and cannot be overlooked. There is no recognized principle of law or equity, however, and no federal statute which creates a transferee liability on the death of the grantor of a revocable trust if, at that time and by reason of death, his estate becomes insolvent.

In the prior case involving the executors the Court of Appeals refused to treat the case as moot because the Commissioner knew there was no property left in the estate.

In this case, where the burden to show transferee liability is upon the Commissioner, there is no evidence to show insolvency on March 10, 1924, when the trust was established, and no claim that transferee liability arose on Rew's unexpected death in June of that year. Obviously, some new theory must be found in order to establish the liability of petitioners in this case.

For the above reasons we submit that the decision in this case should be reviewed.

Respectfully submitted,

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September 5, 1940.